

AMERICAN POWER GROUP Corp  
Form 10-Q/A  
June 29, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q/A

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the quarterly period ended June 30, 2014

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-13776

American Power Group Corporation  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

71-0724248  
(I.R.S. Employer  
Identification No.)

7 Kimball Lane, Lynnfield MA  
(Address of principal executive offices)  
(781) 224-2411

01940  
(Zip Code)

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer (do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

As of August 13, 2014 there were 50,544,573 shares of the registrant's Common Stock outstanding.

1

---

We are filing this Amendment No. 1 on Form 10-Q/A to amend and restate in their entirety the following items of our Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 as originally filed with the Securities and Exchange Commission on August 15, 2014 (the "Original Form 10-Q"): (i) Item 1 of Part I "Financial Information," (ii) Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations," (iii) Item 4 of Part I, "Controls and Procedures," and (iv) Item 6 of Part II, "Exhibits", and we have also updated the signature page, the certifications of our Chief Executive Officer and Chief Financial Officer in Exhibits 31.1, 31.2, 32.1 and 32.2, and our financial statements formatted in Extensible Business Reporting Language (XBRL) in Exhibits 101. No other sections were affected, but for the convenience of the reader, this report on Form 10-Q/A restates in its entirety, as amended, our Original Form 10-Q. This report on Form 10-Q/A is presented as of the filing date of the Original Form 10-Q and does not reflect events occurring after that date, or modify or update disclosures in any way other than as required to reflect the explanation and restatement described below. Concurrently with the filing of this Form 10-Q/A, we are also filing Amendment No. 1 on Form 10-K/A to our Annual Report on Form 10-K for the year ended September 30, 2014, as originally filed with the SEC on December 22, 2014 (the "Original Form 10-K"), to provide similar updates.

In conjunction with the private placement of our 10% Convertible Preferred Stock in April 2012, we issued warrants containing anti-dilution adjustment provisions that protect the holders from the dilutive effects of subsequent issuances of our Common Stock at prices below the warrants' exercise prices. These provisions, however unlikely to be triggered, could result in downward adjustments of the exercise prices of the warrants and, therefore, increases in the number of shares of our Common Stock issuable upon their exercise. In October 2012, the Financial Accounting Standards Board issued ASU 2012-04, Technical Corrections and Improvements ("ASU 2012-04"), which contained technical corrections to guidance on which we had previously relied in forming our initial conclusions regarding the accounting for warrants containing these anti-dilution protections. Based upon our extensive review of ASU 2012-04, we have now concluded that these warrants did not meet the criteria for classification as equity, as previously recorded, and must be recorded as a liability, with the value of the warrants recorded at fair value on the transition/effective date, and subsequent changes in fair value recorded in earnings on a quarterly basis. Based on transition guidance provided, we determined our effective/transition date for implementation of ASU 2012-04 to be October 1, 2013.

As a result of the foregoing, we have determined that our previously reported results for the three and nine months ended June 30, 2014 should no longer be relied upon and need to be updated to reflect the retroactive correction of this accounting error and correctly reflect the accounting for the value of the warrants containing anti-dilution protections pursuant to the guidance provided by ASU 2012-04. The condensed consolidated balance sheets, the condensed consolidated statements of operations, the condensed consolidated statement of changes in stockholders (deficit) equity and the condensed consolidated statements of cash flows for the three and nine months ended June 30, 2014 included in this Form 10-Q/A, have been restated to include the effects of the correction of this accounting error. In addition, we have made necessary conforming changes in "Management's Discussion and Analysis of Financial Condition and Results of Operations" resulting from the correction of this error. Our condensed consolidated financial statements (including audit reports), other financial information and related disclosures included in the Original Form 10-K and the Original Form 10-Q, as well as press releases, investor presentations or other communications issued prior to the date hereof that relate to the periods covered by the Original Form 10-K and Original Form 10-Q should not be relied upon and are superseded in their entirety by this Form 10-Q/A and the Form 10-K/A being filed concurrently herewith.

American Power Group Corporation

TABLE OF CONTENTS

|  | Page |
|--|------|
| PART I. FINANCIAL INFORMATION  |      |
| Item 1. Financial Statements   |      |
| <u>Condensed Consolidated Balance Sheets</u> as of June 30, 2014 (Unaudited) and September 30, 2013                                      | 4    |
| <u>Condensed Consolidated Statements of Operations for the three months and nine months ended June 30, 2014 and 2013 (Unaudited)</u>     | 5    |
| <u>Condensed Consolidated Statement of Changes in Stockholders' (Deficit) Equity for the nine months ended June 30, 2014 (Unaudited)</u> | 6    |
| <u>Condensed Consolidated Statements of Cash Flows for the nine months ended June 30, 2014 and 2013 (Unaudited)</u>                      | 7    |
| <u>Notes to Condensed Interim Consolidated Financial Statements (Unaudited)</u>  | 9    |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                     | 18   |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 20   |
| Item 4. <u>Controls and Procedures</u>   | 20   |
| PART II. OTHER INFORMATION   |      |
| Item 1. <u>Legal Proceedings</u>   | 21   |
| Item 1A. <u>Risk Factors</u>   | 21   |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>   | 21   |
| Item 3. <u>Defaults Upon Senior Securities</u>   | 21   |
| Item 4. <u>Mine Safety Disclosures</u>   | 21   |
| Item 5. <u>Other Information</u>   | 21   |
| Item 6. <u>Exhibits</u>  | 22   |
| <u>Signatures</u>  | 23   |



American Power Group Corporation  
Condensed Consolidated Balance Sheets

|  | June 30,<br>2014<br>(Unaudited) | September 30,<br>2013 |
|--|---------------------------------|-----------------------|
| <b>ASSETS</b>  |                                 |                       |
| Current assets:  |                                 |                       |
| Cash and cash equivalents  | \$1,237,854                     | \$1,684,169           |
| Certificates of deposit, restricted  | 300,000                         | 300,000               |
| Accounts receivable, trade, less allowance for doubtful accounts of \$80,589 and \$120,393 as of June 30, 2014 and September 30, 2013, respectively                  | 1,672,840                       | 1,612,280             |
| Inventory  | 770,355                         | 908,059               |
| Prepaid expenses   | 170,989                         | 150,816               |
| Other current assets   | 40,185                          | 48,472                |
| Assets related to discontinued operations  | —                               | 66,922                |
| Total current assets   | 4,192,223                       | 4,770,718             |
| Property, plant and equipment, net   | 784,248                         | 929,821               |
| Other assets:  |                                 |                       |
| Seller's note, related party   | 797,387                         | 797,387               |
| Long term contracts, net   | 254,167                         | 291,667               |
| Purchased technology, net  | 254,167                         | 291,667               |
| Software development costs, net  | 3,135,333                       | 3,180,804             |
| Other  | 165,547                         | 134,469               |
| Total other assets   | 4,606,601                       | 4,695,994             |
|  | \$9,583,072                     | \$10,396,533          |
| <b>LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY</b>  |                                 |                       |
| Current liabilities:   |                                 |                       |
| Accounts payable   | \$974,502                       | \$1,086,347           |
| Accrued expenses   | 1,029,718                       | 914,023               |
| Billings in excess of cost   | —                               | 7,533                 |
| Notes payable, current   | 2,610,291                       | 106,972               |
| Notes payable, related parties   | 443,500                         | 473,500               |
| Obligations due under lease settlement, current  | 68,518                          | 68,518                |
| Total current liabilities  | 5,126,529                       | 2,656,893             |
| Notes payable, non-current   | 43,914                          | 1,490,160             |
| Warrant liability  | 9,628,858                       | —                     |
| Obligations due under lease settlement, non-current  | 505,540                         | 505,540               |
| Total liabilities  | 15,304,841                      | 4,652,593             |
| Stockholders' (deficit) equity:  |                                 |                       |
| Preferred stock, \$1.00 par value, 998,854 shares authorized, 0 shares issued and outstanding  | —                               | —                     |
| 10% Convertible Preferred stock, \$1.00 par value, 1,146 shares authorized, 941 shares and 942 shares issued and outstanding at June 30, 2014 and September 30, 2013 |                                 | 942                   |
| Common stock, \$.01 par value, 150 million shares authorized, 50,515,805 shares and 48,375,316 shares issued and outstanding at June 30, 2014 and September 30, 2013 | 505,159                         | 483,753               |

Edgar Filing: AMERICAN POWER GROUP Corp - Form 10-Q/A

|                                      |             |               |   |
|--------------------------------------|-------------|---------------|---|
| Additional paid-in capital           | 58,111,181  | 66,570,909    |   |
| Accumulated deficit                  | (64,339,050 | ) (61,311,664 | ) |
| Total stockholders' (deficit) equity | (5,721,769  | ) 5,743,940   |   |
|                                      | \$9,583,072 | \$10,396,533  |   |

See accompanying notes to unaudited condensed interim consolidated financial statements.

American Power Group Corporation  
Condensed Consolidated Statements of Operations  
(Unaudited)

|   | Three Months Ended June 30, |              | Nine Months Ended<br>June 30, |                |
|---|-----------------------------|--------------|-------------------------------|----------------|
|   | 2014                        | 2013         | 2014                          | 2013           |
| Net sales   | \$1,782,269                 | \$2,151,454  | \$4,883,279                   | \$4,878,568    |
| Cost of sales   | 1,267,322                   | 1,141,250    | 3,119,749                     | 2,851,461      |
| Gross profit  | 514,947                     | 1,010,204    | 1,763,530                     | 2,027,107      |
| Operating expenses:   |                             |              |                               |                |
| Selling, general and administrative                                     | 1,133,522                   | 1,086,918    | 3,057,613                     | 3,235,543      |
| Operating loss from continuing operations                               | (618,575 )                  | (76,714 )    | (1,294,083 )                  | (1,208,436 )   |
| Non operating income (expense)  |                             |              |                               |                |
| Interest and financing costs  | (48,444 )                   | (39,462 )    | (139,448 )                    | (126,831 )     |
| Interest income   | 11,026                      | 11,579       | 33,321                        | 35,094         |
| Revaluation of warrants   | 8,559,943                   | —            | (801,809 )                    | —              |
| Other, net  | (27,669 )                   | (35,136 )    | (102,552 )                    | (89,856 )      |
| Non operating income (expense), net                                     | 8,494,856                   | (63,019 )    | (1,010,488 )                  | (181,593 )     |
| Net income (loss)   | 7,876,281                   | (139,733 )   | (2,304,571 )                  | (1,390,029 )   |
| 10% Convertible Preferred dividends                                     | (242,329 )                  | (244,464 )   | (722,815 )                    | (644,560 )     |
| Net income (loss) available to Common stockholders                      | \$7,633,952                 | \$(384,197 ) | \$(3,027,386 )                | \$(2,034,589 ) |
| Income (loss) from continuing operations per share                      | \$0.16                      | \$—          | \$(0.05 )                     | \$(0.03 )      |
| Net income (loss) per Common share - 10% Preferred dividend             | (0.01 )                     | (0.01 )      | (0.02 )                       | (0.01 )        |
| Net income (loss) attributable to Common stockholders per share         | \$0.15                      | \$(0.01 )    | \$(0.07 )                     | \$(0.04 )      |
| Net income (loss) per common share attributable to Common stockholders: |                             |              |                               |                |
| Basic   | \$0.15                      | \$(0.01 )    | \$(0.07 )                     | \$(0.04 )      |
| Diluted   | \$0.10                      | \$(0.01 )    | \$(0.07 )                     | \$(0.04 )      |
| Weighted average shares outstanding:                                    |                             |              |                               |                |
| Basic   | 50,364,666                  | 46,869,240   | 49,268,170                    | 46,269,996     |
| Diluted   | 75,330,693                  | 46,869,240   | 49,268,170                    | 46,269,996     |



See accompanying notes to unaudited condensed interim consolidated financial statements.

5

---

American Power Group Corporation  
Condensed Consolidated Statement of Changes in Stockholders' (Deficit) Equity  
For the Nine Months Ended June 30, 2014  
(Unaudited)

|  | Preferred Stock |        | Common Stock |           | Additional         | Accumulated    |               |
|--|-----------------|--------|--------------|-----------|--------------------|----------------|---------------|
|  | Shares          | Amount | Shares       | Amount    | Paid In<br>Capital | Deficit        | Total         |
| Balance, October 1, 2013   | 942             | \$942  | 48,375,316   | \$483,753 | \$66,570,909       | \$(61,311,664) | \$5,743,940   |
| Cumulative effect of a<br>change in accounting<br>principle - adoption of ASU<br>2012-04 | —               | —      | —            | —         | (10,652,540 )      | —              | (10,652,540 ) |
| Compensation expense<br>associated with stock options                                    | —               | —      | —            | —         | 60,117             | —              | 60,117        |
| Common stock issued upon<br>option and warrant exercise                                  | —               | —      | 1,773,364    | 17,734    | 37,233             | —              | 54,967        |
| Common stock issued upon<br>Preferred stock conversion                                   | (1 )            | (1 )   | 8,870        | 89        | (88 )              | —              | —             |
| Additional fees related to<br>issuance of 10% Convertible<br>Preferred Stock             | —               | —      | —            | —         | (27,665 )          | —              | (27,665 )     |
| Fair value of warrant liability<br>reclassified as additional<br>paid in capital         | —               | —      | —            | —         | 1,825,491          | —              | 1,825,491     |
| Common stock issued for<br>10% Convertible Preferred<br>stock dividend                   | —               | —      | 358,255      | 3,583     | 297,724            | (301,307 )     | —             |
| 10% Convertible Preferred<br>stock dividend paid in cash                                 | —               | —      | —            | —         | —                  | (421,508 )     | (421,508 )    |
| Net loss for the nine months<br>ended June 30, 2014                                      | —               | —      | —            | —         | —                  | (2,304,571 )   | (2,304,571 )  |
| Balance, June 30, 2014   | 941             | \$941  | 50,515,805   | \$505,159 | \$58,111,181       | \$(64,339,050) | \$(5,721,769) |

See accompanying notes to unaudited condensed interim consolidated financial statements.

6

---

American Power Group Corporation  
Condensed Consolidated Statements of Cash Flows  
(Unaudited)

|   | Nine Months Ended June 30, |                |
|---|----------------------------|----------------|
|   | 2014                       | 2013           |
| Cash flows from operating activities:                                       |                            |                |
| Net loss  | \$(2,304,571               | ) \$(1,390,029 |
| Adjustments to reconcile net loss to net cash used in operating activities: |                            |                |
| Revaluation of warrants   | 801,809                    | —              |
| Shares issued for services rendered   | —                          | 424,549        |
| (Gain) loss on disposal of property and equipment                           | (12,743                    | ) 682          |
| Depreciation expense  | 250,755                    | 189,860        |
| Amortization of deferred financing costs                                    | 10,244                     | —              |
| Stock compensation expense  | 60,117                     | 97,396         |
| Provision for bad debts   | 20,839                     | —              |
| Amortization of software costs  | 338,785                    | 167,307        |
| Amortization of long term contracts   | 37,500                     | 37,499         |
| Amortization of purchased technology  | 37,500                     | 37,499         |
| (Increase) decrease in assets:  |                            |                |
| Accounts receivable   | (56,999                    | ) (593,064     |
| Inventory   | 137,704                    | (398,323       |
| Costs in excess of billings   | —                          | 30,411         |
| Prepaid and other current assets  | (12,130                    | ) (126,328     |
| Other assets  | (31,078                    | ) (900         |
| Assets related to discontinued operations                                   | 66,922                     | —              |
| (Decrease) increase in liabilities:   |                            |                |
| Accounts payable  | (144,065                   | ) (238,275     |
| Billings in excess of costs   | (7,533                     | ) —            |
| Accrued expenses  | 105,695                    | 57,913         |
| Net cash used in operating activities                                       | (701,249                   | ) (1,703,803   |
| Cash flows from investing activities:                                       |                            |                |
| Purchase of property and equipment  | (111,632                   | ) (824,499     |
| Software development costs  | (266,301                   | ) (1,407,377   |
| Net cash used in investing activities                                       | (377,933                   | ) (2,231,876   |
| Cash flows from financing activities:                                       |                            |                |
| Proceeds from notes payable   | 1,220,860                  | 179,945        |
| Repayment of notes payable  | (163,787                   | ) (619,250     |
| Repayment of notes payable, related party                                   | (30,000                    | ) —            |
| Proceeds from sale of 10% Convertible Preferred stock, net of fees          | —                          | 2,646,279      |
| Proceeds from exercise of stock options                                     | 54,967                     | 22,979         |
| Payment made for fees related to 10% Convertible Preferred stock            | (27,665                    | ) —            |
| Payment of cash dividend on 10% Convertible Preferred stock                 | (421,508                   | ) (281,735     |
| Net cash provided by financing activities                                   | 632,867                    | 1,948,218      |
| Net decrease in cash and cash equivalents                                   | (446,315                   | ) (1,987,461   |
| Cash and cash equivalents at beginning of year                              | 1,684,169                  | 4,423,485      |
| Cash and cash equivalents at end of period                                  | \$1,237,854                | \$2,436,024    |

See accompanying notes to unaudited condensed interim consolidated financial statements.

7

---

American Power Group Corporation  
 Condensed Consolidated Statements of Cash Flows  
 (Unaudited)

-Continued-

|  | Nine Months Ended June 30, |            |
|--|----------------------------|------------|
|  | 2014                       | 2013       |
| Supplemental disclosure of cash flow information:  |                            |            |
| Interest paid  | \$ 118,899                 | \$ 130,491 |
| Taxes paid   | —                          | 2,248      |
| Supplemental disclosure of non-cash investing and financing activities:  |                            |            |
| Reclassification of the estimated fair value of warrants exercised during the period to additional paid in capital | \$ 1,825,491               | \$—        |
| Shares issued for preferred stock dividend   | 301,307                    | 362,825    |
| Software development costs included in accounts payable and accrued expenses                                       | 27,013                     | 520,047    |
| Property and equipment included in accounts payable  | 5,207                      | —          |
| Inventory transferred to equipment and capitalized software  | —                          | 5,093      |

See accompanying notes to unaudited condensed interim consolidated financial statements.

8

---

American Power Group Corporation  
Notes to Condensed Interim Consolidated Financial Statements  
(Unaudited)

1. Nature of Operations, Risks, and Uncertainties

Effective August 1, 2012, GreenMan Technologies, Inc. (the "Company") changed its name to American Power Group Corporation ("APG"). In connection with the corporate name change, the Company's stock trading symbol on the OTCQB has changed from "GMTI" to "APGI". APG (together with its subsidiaries "we", "us" or "our") was originally founded in 1992 and has operated as a Delaware corporation since 1995.

Recent Developments

In April 2014, we notified M&R Development, LLC, our Iowa landlord, of our intent to exercise our option to renew our existing lease for an additional 2 year term through May 2017. In December 2013, Iowa State Bank agreed to extend the maturity of our \$2.25 million credit facility from December 31, 2013 to April 1, 2015, increase our borrowing limit to \$2.5 million and expand our collateral base to include certain fixed assets which will provide more working capital availability under the credit facility.

Nature of Operations, Risks, and Uncertainties

Our patented dual fuel conversion system is a unique external fuel delivery enhancement system that converts existing diesel engines into more efficient and environmentally friendly engines that have the flexibility, depending on the circumstances, to run on:

- Diesel fuel and compressed natural gas (CNG) or liquefied natural gas (LNG);
- Diesel fuel and pipeline gas, well-head gas or approved bio-methane; or
- 100% diesel fuel.

Our proprietary technology seamlessly displaces up to 75% (average displacement ranges from 40% to 65%) of the normal diesel fuel consumption with various forms of natural gas. Installation requires no engine modification, unlike the more expensive fuel injected alternative fuel systems in the market.

By displacing highly polluting and expensive diesel fuel with inexpensive, abundant and cleaner burning natural gas, a user can:

- Reduce fuel and operating costs by 15% to 35%;
- Reduce toxic emissions such as nitrogen oxide (NOX), carbon monoxide (CO) and fine particulate emissions; and
- Enhance the engine's operating life, since natural gas is a cleaner burning fuel source.

Primary end market applications include both primary and back-up diesel generators as well as heavy-duty vehicular diesel engines.

As of June 30, 2014, we had \$1,537,854 cash, cash equivalents and restricted certificates of deposit and working capital deficiency of \$934,306. As of June 30, 2014, we had drawn down on the maximum under our \$2.5 million credit facility with Iowa State Bank and no additional funds were available to us under that line of credit. Subsequent to June 30, 2014, we repaid Iowa State Bank \$550,000 of the outstanding balance and as of August 14, 2014, we have a maximum borrowing availability of \$235,000, subject to adequate collateral. The credit facility with Iowa State Bank matures on April 1, 2015.

Based on our fiscal 2014 operating budget, cash on hand at June 30, 2014, anticipated availability under our bank working capital line and the successful renewal of our credit facility beyond April 1, 2015, we believe we will be able to satisfy our cash requirements through at least the second quarter of calendar 2015 without the need to materially modify our operating plan. We are currently in discussions with Iowa State Bank regarding potential revisions to our credit facility to extend the term as well as gain access to additional availability. We are also evaluating other financing alternatives should we determine the need to supplement existing cash flows from operations in order to fund operations or accelerate certain revenue related initiatives. We understand our continued existence is dependent on our ability to generate positive operating cash flow, achieve profitability on a sustained basis and generate improved performance. If we are unable to achieve and sustain profitability and we are unable to obtain additional financing to supplement our cash position, our ability to maintain our current level of operations could be materially



and adversely affected. There is no guarantee we will be able to restructure our credit facility, obtain other financing, or achieve profitability.

2. Basis of Presentation

The consolidated financial statements include the accounts of APG and our wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

9

---

The accompanying interim financial statements at June 30, 2014 are unaudited and should be read in conjunction with the financial statements and notes thereto for the year ended September 30, 2013 included in our Annual Report on Form 10-K. The balance sheet at September 30, 2013 has been derived from the audited financial statements as of that date; certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the Securities and Exchange Commission rules and regulations, although we believe the disclosures which have been made herein are adequate to ensure that the information presented is not misleading. The results of operations for the interim periods reported are not necessarily indicative of those that may be reported for a full year. In our opinion, all adjustments which are necessary for a fair statement of our financial position as of June 30, 2014 and the operating results for the interim periods ended June 30, 2014 and 2013 have been included.

### 3. Correction of an Accounting Error

The warrants issued in connection with our 10% Convertible Preferred Stock contain anti-dilution protection provisions including certain reset features (down-round protection) which protects the holders from future issuances of our Common Stock at prices below such warrants' then-in-effect respective exercise prices (See Note 12). This provision, however unlikely to occur, could result in modification of the warrants then-in-effect. In October 2012, the Financial Accounting Standards Board (FASB), issued ASU 2012-04 Technical Corrections and Improvement ("ASU 2012-04") which contained technical corrections to guidance on which we had previously relied upon in forming our initial conclusions regarding the accounting for warrants containing these reset provisions relating to the April 2012 private placement of our 10% Convertible Preferred Stock. Based upon our extensive review of ASU 2012-04, we have concluded these warrants no longer meet the criteria for classification as equity as previously recorded and must be recorded as a liability with the value of the warrants recorded at fair value on the transition/effective date, with subsequent changes in fair value recorded in earnings on a quarterly basis. Based on transition guidance provided, we determined our effective/transition date for implementation of ASU 2012-04 to be October 1, 2013 and the consolidated condensed financial statements contained herein reflect the retroactive impact of this correction of this accounting error as of this date. The restated historical information is as follows:

#### Condensed Consolidated Statements of Operations

|   | Three Months Ended June 30, 2014 |             |             | Nine Months Ended June 30, 2014 |             |               |
|---|----------------------------------|-------------|-------------|---------------------------------|-------------|---------------|
|   | Originally Reported              | Adjustments | Adjusted    | Originally Reported             | Adjustments | Adjusted      |
| Non operating income (expense):   |                                  |             |             |                                 |             |               |
| Revaluation of warrants   | \$—                              | \$8,559,943 | \$8,559,943 | \$—                             | \$(801,809) | \$(801,809)   |
| Non operating income (expense), net                                     | (65,087)                         | 8,559,943   | 8,494,856   | (208,679)                       | (801,809)   | (1,010,488)   |
| Net income (loss)   | (683,662)                        | 8,559,943   | 7,876,281   | (1,502,762)                     | (801,809)   | (2,304,571)   |
| Net income (loss) available to Common Stockholders                      | \$(925,991)                      | \$8,559,943 | \$7,633,952 | \$(2,225,577)                   | \$(801,809) | \$(3,027,386) |
| Income (loss) from continuing operations per share                      | \$(0.01)                         | \$0.17      | \$0.16      | \$(0.03)                        | \$(0.02)    | \$(0.05)      |
| Net income (loss) per common share attributable to Common stockholders: |                                  |             |             |                                 |             |               |
| Basic   | \$(0.01)                         | \$0.16      | \$0.15      | \$(0.03)                        | \$(0.04)    | \$(0.07)      |
| Diluted   | (0.01)                           | 0.11        | \$0.10      | (0.03)                          | (0.04)      | (0.07)        |



## Condensed Consolidated Balance Sheets

|  | As of June 30, 2014 |              |               |
|--|---------------------|--------------|---------------|
|  | Originally Reported | Adjustments  | Adjusted      |
| <b>Liabilities:</b>                    |                     |              |               |
| Warrant liability                      | \$—                 | \$9,628,858  | \$9,628,858   |
| Total liabilities                      | 5,675,983           | 9,628,858    | 15,304,841    |
| <b>Stockholders' (deficit) equity:</b> |                     |              |               |
| Additional paid-in capital             | 66,938,230          | (8,827,049 ) | 58,111,181    |
| Accumulated deficit                    | (63,537,241 )       | (801,809 )   | (64,339,050 ) |
| Total stockholders' (deficit) equity   | 3,907,089           | (9,628,858 ) | (5,721,769 )  |
|  | \$9,583,072         | \$—          | \$9,583,072   |

## Condensed Consolidated Statement of Stockholders' (Deficit) Equity

|                        | Preferred Stock |        | Common Stock |           | Additional Paid In Capital | Accumulated Deficit | Total         |
|------------------------|-----------------|--------|--------------|-----------|----------------------------|---------------------|---------------|
|                        | Shares          | Amount | Shares       | Amount    |                            |                     |               |
| Originally Reported:   |                 |        |              |           |                            |                     |               |
| Balance, June 30, 2014 | 941             | \$941  | 50,515,805   | \$505,159 | \$66,938,230               | \$(63,537,241)      | \$3,907,089   |
| Adjustments            | —               | —      | —            | —         | (8,827,049 )               | (801,809 )          | (9,628,858 )  |
| Adjusted:              |                 |        |              |           |                            |                     |               |
| Balance, June 30, 2014 | 941             | \$941  | 50,515,805   | \$505,159 | \$58,111,181               | \$(64,339,050)      | \$(5,721,769) |

## Condensed Consolidated Statements of Cash Flows

|  | Nine Months Ended June 30, 2014 |              |                |
|--|---------------------------------|--------------|----------------|
|  | Originally Reported             | Adjustments  | Adjusted       |
| <b>Cash flows from operating activities:</b> |                                 |              |                |
| Net loss                                     | \$(1,502,762 )                  | \$(801,809 ) | \$(2,304,571 ) |
| Revaluation of warrants                      | —                               | 801,809      | 801,809        |
| Net cash used in operating activities        | (701,249 )                      | —            | (701,249 )     |

## 4. Certificates of Deposit

All certificate of deposit investments have an original maturity of more than three months but less than three years and are stated at original purchase price which approximates fair value. As of June 30, 2014 and September 30, 2013, we have pledged a \$300,000 certificate of deposit as collateral for outstanding loans with Iowa State Bank.

## 5. Receivables

## Accounts Receivable

Accounts receivable are carried at original invoice amount less an estimate made for doubtful accounts. Management determines the allowance for doubtful accounts by regularly evaluating past due individual customer receivables and considering a customer's financial condition, credit history, and the current economic conditions. Individual accounts receivable are written off when deemed uncollectible, with any future recoveries recorded as income when received.

## Seller's Note Receivable, Related Party

In conjunction with the July 2009 acquisition of substantially all the American Power Group operating assets, including the name American Power Group (excluding its dual fuel patent), we acquired a promissory note from the previous owners of American



Power Group (renamed M&R Development, Inc.), payable to us, in the principal amount of \$797,387. The note bears interest at the rate of 5.5% per annum and was based on the difference between the assets acquired and the consideration given.

In conjunction with our 10% Convertible Preferred Stock financing in April 2012, we amended the note to increase the amount of royalties payable under a technology license (see Note 6) that can be applied to the outstanding principal and interest payments to 50% and defer all interest and principal payments due under the note during calendar 2012 and 2013. Thereafter, the aggregate principal amount due under the note was to be paid in eight equal quarterly payments plus interest. In addition, M&R will not be required to make any payments under the note until such time as we begin to make royalty payments and then, those payments will be limited to a maximum of 50% of any royalty payment due M&R on a quarterly basis. No payments have been made under the amended note as of June 30, 2014. We have classified 100% of the balance as long term. We consider this a related party note as one of the former owners of American Power Group is now an employee of ours.

#### 6. Inventory

Raw material inventory primarily consists of dual fuel conversion components. Work in progress includes materials, labor and direct overhead associated with incomplete dual fuel conversion projects. As of June 30, 2014 and September 30, 2013, we recorded an inventory valuation allowance of \$42,206 and \$44,073, respectively.

All inventory is valued at the lower of cost or market on the first-in first-out (FIFO) method. Inventory consists of the following:

|                  | June 30,<br>2014 | September 30,<br>2013 |
|------------------|------------------|-----------------------|
| Raw materials    | \$757,104        | \$895,905             |
| Work in progress | 12,125           | 11,423                |
| Finished goods   | 1,126            | 731                   |
| Total inventory  | \$770,355        | \$908,059             |

#### 7. Intangible Assets

We review intangibles for impairment annually, or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of our intangible assets below their carrying value.

In conjunction with the American Power Group acquisition and license agreement, we recorded intangible assets of \$500,000 associated with the execution of a long term technology license agreement and \$500,000 associated with the purchase of the dual fuel conversion technology. Both values are being amortized on a straight line basis over an estimated useful life of 120 months. Amortization expenses associated with the long term technology license agreement and the purchased dual fuel conversion technology amounted to \$25,000 and \$75,000 for the three months and nine months ended June 30, 2014 and 2013, respectively. Accumulated amortization was \$491,666 at June 30, 2014 and \$416,666 at September 30, 2013.

In conjunction with the 10% Convertible Preferred Stock financing in April 2012, we amended the M&R technology license agreement to modify the calculation and the timing of the royalty payments. Under the provisions of this amendment, effective April 27, 2012, the monthly royalty due is the lesser of 10% of net sales or 30% of pre-royalty EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization). No royalties will be earned and due until such time as our cumulative EBITDA commencing April 1, 2012 is positive on a cumulative basis. During the three months and nine months ended June 30, 2014 and 2013, we incurred \$0 royalties to M&R.

A critical component of our dual fuel aftermarket conversion solution is the internally developed software component of our electronic control unit. The software allows us to seamlessly and constantly monitor and control the various gaseous fuels to maximize performance and emission reduction while remaining within all original OEM diesel engine performance parameters. We have developed a base software application and EPA's testing protocol for both our Outside Useful Life ("OUL") and Intermediate Useful Life ("IUL") engine applications, which will be customized for each engine family approved in order to maximize the performance of the respective engine family.

As of June 30, 2014, we have capitalized \$3,791,001 of software development costs associated with our OUL (\$1,801,506) and IUL (\$1,989,495) applications, which will be amortized on a straight line basis over an estimated

useful life of 60 months for OUL applications and 84 months for IUL applications. Amortization costs for the three months and nine months ended June 30, 2014 and 2013 were \$119,807 and \$338,785 and \$68,314 and \$167,308, respectively.

Amortization expense associated with acquisition related intangibles during the next five years is anticipated to be:

| Twelve months ending June 30: | Contracts | Technology | Software Development | Total       |
|-------------------------------|-----------|------------|----------------------|-------------|
| 2014                          | \$50,000  | \$50,000   | \$596,948            | \$696,948   |
| 2015                          | 50,000    | 50,000     | 644,515              | 744,515     |
| 2016                          | 50,000    | 50,000     | 636,811              | 736,811     |
| 2017                          | 50,000    | 50,000     | 507,572              | 607,572     |
| 2018                          | 50,000    | 50,000     | 289,550              | 389,550     |
| 2019 and thereafter           | 4,167     | 4,167      | 459,937              | 468,271     |
|                               | \$254,167 | \$254,167  | \$3,135,333          | \$3,643,667 |

#### 8. Contracts in Progress

Contracts in progress consist of the following:

|  | June 30,<br>2014 | September 30,<br>2013 |
|--|------------------|-----------------------|
| Costs incurred on uncompleted contracts            | \$14,572         | \$14,572              |
| Estimated earnings on contracts in progress        | 25,387           | 25,387                |
|  | 39,959           | 39,959                |
| Less billings on contracts in progress             | 39,959           | 47,492                |
|  | \$—              | \$(7,533)             |
| Costs and estimated earnings in excess of billings | \$—              | \$—                   |
| Billings in excess of costs and estimated earnings | —                | 7,533                 |
|  | \$—              | \$(7,533)             |

#### 9. Property, Plant and Equipment

Property, plant and equipment consist of the following:

|                               | June 30,<br>2014 | September 30,<br>2013 | Estimated<br>Useful Lives |
|-------------------------------|------------------|-----------------------|---------------------------|
| Leasehold improvements        | \$127,087        | \$127,087             | 5 years                   |
| Machinery and equipment       | 1,524,310        | 1,431,871             | 3 - 7 years               |
| Less accumulated depreciation | (867,149)        | (629,137)             |                           |
|                               | \$784,248        | \$929,821             |                           |

#### 10. Product Warranty Costs

We provide for the estimated cost of product warranties for our dual fuel products at the time product revenue is recognized. Factors that affect our warranty reserves include the number of units sold, historical and anticipated rates of warranty repairs, and the cost per repair. We assess the adequacy of the warranty provision and we may adjust this provision if necessary. The increase in warranty reserve and the claims processed for the nine months ended June 30, 2014 and for the year ended September 30, 2013, are attributable to the increase in our revenue during those periods. The following table provides the detail of the change in our product warranty accrual relating to dual fuel products as of:

|   | Nine Months Ended<br>June 30, 2014 | Year Ended<br>September 30, 2013 |
|---|------------------------------------|----------------------------------|
| Warranty accrual at the beginning of the period     | \$118,591                          | \$18,306                         |
| Charged to costs and expenses relating to new sales | 88,542                             | 146,594                          |
| Costs of product warranty claims                    | (74,856)                           | (46,309)                         |
| Warranty accrual at the end of period               | \$132,277                          | \$118,591                        |



## 11. Notes Payable/Credit Facilities

### Credit Facilities

We have a \$2,500,000 credit facility with Iowa State Bank under which we may borrow up to 50% of the value of eligible inventory, 75% of eligible accounts receivable, 100% of our certificate of deposit and 50% of eligible machinery and equipment. This credit facility is due April 1, 2015 and bears interest of 7%. We have collateralized the obligation by: (i) granting to the lender a security interest in our \$300,000 certificate of deposit and certain additional collateral and (ii) pledging to the lender, as additional collateral, 2,000,000 shares of our Common Stock. In addition, two directors and two members of management have each pledged 125,000 shares of our Common Stock owned by them as additional collateral.

As of June 30, 2014, we have \$2,500,000 outstanding under the credit facility and do not have additional borrowing availability based on existing collateral under the terms of our working capital line. Subsequent to June 30, 2014, we repaid Iowa State Bank \$550,000 of the outstanding balance. We are currently in discussions with the bank regarding the potential restructuring of our credit facility to extend the term as well as gain access to additional availability.

### Notes Payable, Related Party

In September and October 2010, an officer and former director loaned us a total of \$323,500 in connection with a private placement of 12% six-month promissory notes. In October 2011, an officer loaned us \$150,000 pursuant to the terms of a 10% promissory note due November 27, 2011. In conjunction with the 10% Convertible Preferred Stock financing in April 2012, these officers and former director agreed to extend the maturity of their notes until April 30, 2014 and reduce their interest rate to 8%. These notes have been classified as short term as of June 30, 2014.

On April 30, 2014, the two officers agreed to extend the maturity of their notes totaling \$200,000 in aggregate until September 30, 2014 and the holder of the former director's note agreed to payments of \$15,000 per month starting May 15, 2014 with the remaining balance due September 30, 2014.

### 12. Warrants to Purchase Common Stock

In conjunction with the private placement of our 10% Convertible Preferred stock in April 2012, we issued warrants which contained a "down-round" provision that provides for a reduction in the warrant exercise price if there are subsequent issuances of additional shares of common stock for consideration per share less than the per share warrant exercise prices. In October 2012, the Financial Accounting Standards Board (FASB), issued ASU 2012-04 Technical Corrections and Improvement ("ASU 2012-04") which contained technical corrections to guidance on which we had previously relied upon in forming our initial conclusions regarding the accounting for warrants containing these reset provisions. Pursuant to this guidance and effective commencing October 1, 2013, we have recognized the fair value of these warrants as a liability and have re-measured the fair value of these warrants on a quarterly basis with any increase or decrease in the estimated fair value being recorded in other income or expense for the respective quarterly reporting period.

We have historically used the Black-Scholes option pricing model to determine the fair value of options and warrants. We have considered the facts and circumstances in choosing the Black-Scholes model to calculate the fair value of the warrants with a down-round price protection feature as well as the likelihood of triggering the down-round price protection feature, which, as described below, we have concluded is remote.

In determining the initial fair value of the warrants as of October 1, 2013, we prepared a valuation simulation using the Black Scholes option pricing model as well as additional models using a modified Black Scholes option pricing model and a Binomial Tree option pricing model. Both additional simulations included various reset scenarios, different exercise prices, and other assumptions, such as price volatility and interest rates, that were kept consistent with our original Black-Scholes model. The resulting warrant values as determined under the modified Black-Scholes model and the Binomial Tree option model were not materially different from the values generated using the Black-Scholes model. We have therefore determined to use the Black-Scholes model as we believe it provides a reasonable basis for valuation and takes into consideration the relevant factors of the warrants, including the down round provision.

During the three and nine months ended June 30, 2014, we recorded warrant valuation income of \$8,559,943 and warrant valuation expense of \$801,809, respectively associated with the change in the fair value of all warrants containing the down round provision outstanding as of June 30, 2014 and exercised during the three and nine months

ended June 30, 2014. During the nine months ended June 30, 2014, warrants to purchase 2,755,483 shares of Common Stock containing the down round provision were exercised on a cashless basis. We reduced our warrant liability on the date of exercise by the estimated fair value of these warrants which was \$1,825,491 and reclassified this amount to Additional paid-in capital. Our warrant liability was \$9,628,858 as of June 30, 2014.

The warrant liabilities were valued at June 30, 2014 using the Black-Scholes option-pricing model with the following assumptions.

| Warrants   | 10% Convertible Preferred Stock Financing |  |
|--|---|--|
|  | Private Placement 1<br>June 30<br>2014    | Private Placement 2<br>June 30<br>2014 |
| Closing price per share of common stock                  | \$0.75                                    | \$0.75                                 |
| Exercise price per share                                 | 0.50                                      | 0.50                                   |
| Expected volatility                                      | 58.0                                      | % 58.0                                 |
| Risk-free interest rate                                  | 1.0                                       | % 1.3                                  |
| Dividend yield   | —   | —                                      |
| Remaining expected term of underlying securities (years) | 3.3                                       | 4.3                                    |
| Warrants outstanding                                     | 17,623,387                                | 6,032,787                              |

Private Placement 1 - April 30, 2012, sale of 821.6 units of 10% Convertible Preferred Stock

Private Placement 2 - March 31, 2013, additional investment right from Private Placement 1, sale of approximately 274 units of 10% Convertible Preferred Stock.

### 13. Fair Value Measurements

The carrying amount of our receivables and payables approximate their fair value due to their short maturities.

Accounting principles provide guidance for using fair value to measure assets and liabilities. The guidance includes a three level hierarchy of valuation techniques used to measure fair value, defined as follows:

• **Level 1 - Unadjusted Quoted Prices.** The fair value of an asset or liability is based on unadjusted quoted prices in active markets for identical assets or liabilities.

• **Level 2 - Pricing Models with Significant Observable Inputs.** The fair value of an asset or liability is based on information derived from either an active market quoted price, which may require further adjustment based on the attributes of the financial asset or liability being measured, or an inactive market transaction.

• **Level 3 - Pricing Models with Significant Unobservable Inputs.** The fair value of an asset or liability is primarily based on internally derived assumptions surrounding the timing and amount of expected cash flows for the financial instrument. Therefore, these assumptions are unobservable in either an active or inactive market.

We consider an active market as one in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Conversely, we view an inactive market as one in which there are few transactions of the asset or liability, the prices are not current, or price quotations vary substantially either over time or amount market makers. When appropriate, non-performance risk, or that of a counterparty, is considered in determining the fair values of liabilities and assets, respectively.

We have classified certain warrants related to the 10% Convertible Preferred Stock private placements noted in Note 12 as a Level 3 Liability. Assumptions used in the calculation require significant judgment. The unobservable inputs in our valuation model includes the probability of additional equity financing and whether the additional equity financing would trigger a reset on the down-round protection.

The following table summarizes the financial liabilities measured a fair value on a recurring basis as of September 30, 2013 and June 30, 2014.

|                    | Total       | Quoted Prices in<br>Active Markets for<br>Identical Assets or<br>Liabilities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|--------------------|-------------|---|---|--|
| September 30, 2013 |             |   |   |  |
| Warrant liability  | \$—         | \$—   | \$—   | \$—  |
| June 30, 2014      |             |   |   |  |
| Warrant liability  | \$9,628,858 | \$—   | \$—   | \$9,628,858  |

#### Level 3 Valuation

The following table provides a summary of the changes in fair value of our financial liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the nine month period ended June 30, 2014.

|   | Warrant<br>Liability |
|---|----------------------|
| Level 3   |                      |
| Balance at September 30, 2013   | \$—                  |
| Cumulative effect of a change in accounting principle -<br>adoption of ASU 2012-04                                    | 10,652,540           |
| Revaluation of warrants recognized in earnings  | 801,809              |
| Reclassification of the estimated fair value of warrants exercised during the period to<br>additional paid in capital | \$(1,825,491)        |
| Balance at June 30, 2014  | \$9,628,858          |

#### 14. Stockholders' Equity

##### Common Stock

During the nine months ended June 30, 2014, holders exercised options and warrants to purchase an aggregate of 3,294,296 shares of Common Stock at exercise prices ranging from \$0.28 to \$0.65 utilizing a cashless exercise feature resulting in the net issuance of 1,674,151 shares of Common Stock. In addition, warrants were exercised to purchase 99,213 shares of Common Stock at exercise prices ranging from \$0.48 to \$0.65.

During the nine months ended June 30, 2014, 0.35 shares of 10% Convertible Preferred Stock were converted into 8,870 shares of Common Stock.

##### 10% Convertible Preferred Stock

During the nine months ended June 30, 2014, we recorded a dividend on our 10% Convertible Preferred Stock of \$722,815, of which \$421,508 was paid in cash. Certain stockholders agreed to accept 358,255 shares of Common Stock (valued at \$301,307) in lieu of cash dividend payments.

During the nine months ended June 30, 2013, we recorded a dividend on our 10% Convertible Preferred Stock of \$644,560, of which \$281,733 was paid in cash. Certain stockholders agreed to accept 548,234 shares of Common Stock (valued at \$362,825) in lieu of cash dividend payments.

##### Stock Options

Amortization of stock compensation expense was \$13,951 and \$60,120 for the three months and nine months ended June 30, 2014 and \$29,603 and \$97,396 for the three months and nine months ended June 30, 2013. The unamortized compensation expense at June 30, 2014 was 48,240 and will be amortized over a weighted average remaining life of approximately 2.26 years.



#### 15. Recent Accounting Pronouncement

In May 2014, the Financial Account Standards Board issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective on January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or modified retrospective (cumulative effect) transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect for the standard on our ongoing financial reporting.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains certain statements that are "forward-looking." These forward-looking statements and other information are based on our beliefs as well as assumptions made by us using information currently available. The words "anticipate," "believe," "estimate," "expect," "intend," "will," "should" and similar expressions they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events, are subject to certain risks, uncertainties and assumptions, and are not guaranties of future performance. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected, intended or using other similar expressions.

In accordance with the provisions of the Private Securities Litigation Reform Act of 2005, we are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors that could cause actual results to differ materially from those contemplated by the forward-looking statements contained in this Quarterly Report on Form 10-Q. Important factors that could cause actual results to differ from our predictions include those discussed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. Although we have sought to identify the most significant risks to our business, we cannot predict whether, or to what extent, any of such risks may be realized, nor can there be any assurance that we have identified all possible issues which we might face. In addition, assumptions relating to budgeting, marketing, product development and other management decisions are subjective in many respects and thus susceptible to interpretations and periodic revisions based on actual experience and business developments, the impact of which may cause us to alter our marketing, capital expenditure or other budgets, which may in turn affect our financial position and results of operations. For all of these reasons, the reader is cautioned not to place undue reliance on forward-looking statements contained herein, which speak only as of the date hereof. We assume no responsibility to update any forward-looking statements as a result of new information, future events, or otherwise except as required by law.

The following information should be read in conjunction with the unaudited consolidated financial statements and the notes thereto included in Item 1 of this Quarterly Report, and the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K filed for the fiscal year ended September 30, 2013.

### Results of Operations

#### Three Months ended June 30, 2014 Compared to the Three Months ended June 30, 2013

Net sales for the three months ended June 30, 2014 decreased \$369,185 or 17% to \$1,782,269 as compared to net sales of \$2,151,454 for the three months ended June 30, 2013. North American stationary revenues for the three months ended June 30, 2014 were approximately \$1,218,000 which was approximately \$840,000 or 41% lower when compared to North American stationary revenues for the same period of the prior year. Approximately \$1.1 million or 50% of the North American stationary revenue last year was associated with the full turnkey conversion of multiple engines in the high pressure fracturing market. These conversions were at a higher per unit revenue due to the full turnkey nature of the orders as compared to the more typical sale of just our dual fuel systems. Domestic vehicular revenues for the three months ended June 30, 2014 increased \$196,134 or 173% to \$309,829 as compared to the prior year while international vehicular revenues for the three months ended June 30, 2014 were \$254,160 as compared to zero a year ago. The increase was attributable to increased market exposure and sales through our WheelTime member distributor/installer network and the ability to actively solicit customer orders due to the increased number of EPA approvals we have received to date.

During the three months ended June 30, 2014 our gross profit was \$514,947 or 29% of net sales as compared to a gross profit of \$1,010,204 or 47% of net sales for the three months ended June 30, 2013. The decrease in gross profit was primarily due to increased overhead costs and a decrease in revenues. During the quarter we incurred approximately \$200,000 of additional overhead costs associated with our efforts to expand our stationary engine families in response to market demand and upgrades to our stationary solution and vehicular software to increase functionality and field performance. In addition, non-cash amortization of capitalized software costs increased

approximately \$52,000 during the quarter ended June 30, 2014 as the result of increased EPA approvals since last year.

Selling, general and administrative expenses for the three months ended June 30, 2014 increased \$46,604 or 4% to \$1,133,522 as compared to \$1,086,918 for the three months ended June 30, 2013. The increase was primarily attributable to higher wages associated with an increased number of employees which was offset by lower professional and commission related costs.

During the three months ended June 30, 2014, interest and financing expense increased \$8,982 or 23% to \$48,444 as compared to \$39,462 for the three months ended June 30, 2013.

During the three months ended June 30, 2014 the revaluation of our warrant liability to fair value resulted in non-cash revaluation income of \$8,559,943.



Our net income for the three months ended June 30, 2014 increased \$8,016,014 or 5,737% to \$7,876,281 or \$0.01 per basic share as compared to a net loss of \$139,733 or (\$0.00) per basic share for the three months ended June 30, 2013. The calculation of net income (loss) per share available for Common shareholders for the three months ended June 30, 2014 and 2013, reflects the inclusion of 10% Convertible Preferred Stock quarterly dividends of \$242,329 and \$244,464 associated with the issuance of the 10% Convertible Preferred Stock.

Nine Months ended June 30, 2014 Compared to the Nine Months ended June 30, 2013

Net sales for the nine months ended June 30, 2014 increased \$4,711 or 0% to \$4,883,279 as compared to net sales of \$4,878,568 for the nine months ended June 30, 2013. North American stationary revenues for the nine months ended June 30, 2014 were approximately \$3,376,000 which was approximately \$699,000 or 17% lower when compared to North American stationary revenues for the same period of the prior year. Approximately \$2.4 million or 47% of the North American stationary revenue last year was associated with the full turnkey conversion of multiple engines in the high pressure fracturing market. These conversions were at a higher per unit revenue due to the full turnkey nature of the orders as compared to the more typical sale of just our dual fuel systems. Domestic vehicular revenues for the nine months ended June 30, 2014 increased \$513,342 or 76% to \$1,188,685 as compared to the prior year while international vehicular revenues for the nine months ended June 30, 2014 were \$318,986 as compared to \$128,123 a year ago. The increase was attributable to increased market exposure and sales through our WheelTime member distributor/installer network and the ability to actively solicit customer orders due to the increased number of EPA approvals we have received to date.

During the nine months ended June 30, 2014, our gross profit was \$1,763,530 or 36% of net sales as compared to \$2,027,107 or 42% of net sales for the nine months ended June 30, 2013. The decrease in gross profit was primarily due to increased overhead costs. During the nine months ended June 30, 2014, we incurred approximately \$350,000 of additional overhead costs associated with our efforts to expand our stationary engine families in response to market demand and upgrades to our stationary solution and vehicular software to increase functionality and field performance. In addition, amortization of capitalized software costs increased approximately \$171,000 during the nine months ended June 30, 2014 as the result of increased EPA approvals since last year.

Selling, general and administrative expenses for the nine months ended June 30, 2014 decreased \$177,930 or 5% to \$3,057,613 as compared to \$3,235,543 for the nine months ended June 30, 2013. The decrease was primarily attributable to approximately \$393,000 of one-time, non-cash amortization expense associated with the WheelTime member incentive warrants which vested during the nine months ended June 30, 2013. This decrease was offset by higher wages of approximately \$345,000 associated with an increased number of employees.

During the nine months ended June 30, 2014, interest and financing expense increased \$12,617 or 10% to \$139,448 as compared to \$126,831 for the nine months ended June 30, 2013.

During the nine months ended June 30, 2014, the revaluation of our warrant liability to fair value resulted in a non-cash revaluation expense of \$801,809.

Our net loss for the nine months ended June 30, 2014 increased \$914,542 or 66% to \$2,304,571 or (\$0.07) per basic share as compared to a net loss of \$1,390,029 or (\$0.04) per basic share for the nine months ended June 30, 2013. The calculation of net loss per share available for Common shareholders for the nine months ended June 30, 2014 and 2013, reflects the inclusion of quarterly dividends of \$722,815 and \$644,560, respectively, paid on our 10% Convertible Preferred Stock.

#### Liquidity and Capital Resources

As of June 30, 2014, we had \$1,537,854 in cash, cash equivalents and restricted certificates of deposit and working capital deficiency of \$934,306. As of June 30, 2014, we had drawn down on the maximum under our \$2.5 million credit facility with Iowa State Bank and no additional funds were available to us under that line of credit. Subsequent to June 30, 2014, we repaid Iowa State Bank \$550,000 of the outstanding balance and as of August 14, 2014, we have a maximum borrowing availability of \$235,000, subject to adequate collateral. The credit facility with Iowa State Bank matures on April 1, 2015.

Based on our fiscal 2014 operating budget, cash on hand at June 30, 2014, anticipated availability under our bank working capital line and the successful renewal of our credit facility beyond April 1, 2015, we believe we will be able to satisfy our cash requirements through at least the second quarter of calendar 2015 without the need to materially

modify our operating plan. We are currently in discussions with Iowa State Bank regarding potential revisions to our credit facility to extend the term as well as gain access to additional availability. We are also evaluating other financing alternatives should we determine the need to supplement existing cash flows from operations in order to fund operations or accelerate certain revenue related initiatives. We understand our continued existence is dependent on our ability to generate positive operating cash flow, achieve profitability on a sustained basis and generate improved performance. If we are unable to restructure our credit facility, obtain other financing, or achieve and sustain profitability and we are unable to obtain additional financing to supplement our cash position, our ability to maintain our current level of operations could be materially and adversely affected. There is no guarantee we will be able to achieve profitability.

The Condensed Consolidated Statement of Cash Flows reflect events for the nine months ended June 30, 2014 and 2013 as they affect our liquidity. During the nine months ended June 30, 2014, net cash used in operating activities was \$701,249. Our net loss for the nine months ended June 30, 2014 was \$2,304,571. Our cash flow was positively impacted by the following non-cash expenses and changes to our working capital: \$1,536,710 of depreciation, amortization, stock option expense and warrant revaluation expense.

During the nine months ended June 30, 2013, net cash used in operating activities was \$1,703,803. Our net loss for the nine months ended June 30, 2013 was \$1,390,029. Our cash flow was positively impacted by non-cash expenses and changes to our working capital of \$954,110 consisting of depreciation, amortization, warrants and stock options and was offset by an increase of \$991,387 in accounts receivable and inventory.

Net cash used in investing activities was \$377,933 for the nine months ended June 30, 2014, reflecting the capitalization of \$266,301 of costs associated with our dual fuel electronic control unit engine family software applications and the purchase of \$111,632 of property, plant and equipment. Net cash used in investing activities was \$2,231,876 for the nine months ended June 30, 2013, reflecting the capitalization of \$1,407,377 of costs associated with our dual fuel electronic control unit engine family software applications and the purchase of \$824,499 of property, plant and equipment.

Net cash provided by financing activities was \$632,867 during the nine months ended June 30, 2014, reflecting the proceeds of \$1,220,860 from the credit facility plus \$54,967 of proceeds from exercised stock options. Payments made on notes payable totaled \$163,787 and we paid our 10% Preferred Stockholders \$421,508 of 10% preferred dividends. Net cash provided by financing activities was \$1,948,218 during the nine months ended June 30, 2013, reflecting \$2,646,279 in proceeds from the sale of 10% convertible preferred stock, net of fees, \$22,979 of proceeds from exercised stock options and the proceeds of \$179,945 from our credit facility. Payments made on notes payable totaled \$619,250 and we paid our Preferred Stockholders \$281,735 of 10% preferred dividends.

#### Effects of Inflation and Changing Prices

Generally, we are exposed to the effects of inflation and changing prices. Given that our dual fuel conversion technology replaces a certain percentage of diesel fuel with natural gas, we would be impacted by any material change in the net fuel savings between the two fuels (for example, if diesel fuel prices decrease and natural gas prices increase). We have generally been unaffected by interest rate changes in the nine months ended June 30, 2014 and 2013, because we no longer maintain any floating-rate debt.

#### Environmental Liability

There are no known material environmental violations or assessments.

#### New Accounting Pronouncement

In May 2014, the Financial Account Standards Board issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective on January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or modified retrospective (cumulative effect) transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect for the standard on our ongoing financial reporting.

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not required pursuant to Item 305(e) of Regulation S-K.

#### Item 4. Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of June 30, 2014. In designing and evaluating our disclosure controls and procedures, we recognized that any controls and procedures, no matter how well designed and operated, can provide

only reasonable assurance of achieving their objectives and management applies judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, our chief executive officer and chief financial officer identified a material weakness in internal controls over financial reporting as of June 30, 2014 as described below.

Based upon management's evaluation, we concluded that we did not maintain adequate and effective internal control in the area of complex and non-routine transactions as of June 30, 2014. As a result, of a correction of an accounting error described in

Note 3 to our Condensed Consolidated Financial Statements contained herein, restatements of our condensed consolidated financial statements for the period ended December 31, 2013, March 31, 2014 and June 30, 2014 were necessary.

In connection with the material weakness described above management plans to enhance its review and approval procedures and to provide education and implement accounting reviews as they pertain to complex and non-routine transactions.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended June 30, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

None

### Item 1A. Risk Factors

We may require additional funding, which may be difficult to obtain on favorable terms, if at all.

We believe we have sufficient cash available to fund operations through the second quarter of calendar 2015. As of August 14, 2014, we have approximately \$235,000 available, subject to adequate collateral, on our \$2.5 million line of credit from Iowa State Bank. The line of credit matures on April 1, 2015. While we are currently in discussions with Iowa State Bank to revise the credit facility in order to extend the term as well as increase the amount available to us, there is no assurance that Iowa State Bank will agree to revise the facility. In addition, there is no assurance that we will be able to obtain financing from other sources on a timely basis, or on terms acceptable to us. If we fail to obtain acceptable additional financing when needed, we may not have sufficient resources to fund our normal operations after the second quarter of calendar 2015, which would have a material adverse effect on our business.

Other than the risk factors included above, there have not been any material changes from the risk factors previously disclosed under Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2013.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended June 30, 2014, we issued 97,180 shares of our unregistered Common Stock to certain third parties as a result of options and warrants that were exercised. The issuance of these shares is exempt from registration under the Securities Act pursuant to Section 4(2) of the Securities Act.

During the three months ended June 30, 2014, we issued 139,345 shares of Common Stock to certain holders of our 10% Convertible Preferred Stock in lieu of payment of cash dividends. The issuance of these shares is exempt from registration under the Securities Act pursuant to Section 4(2) of the Securities Act.

### Item 3. Defaults Upon Senior Securities

None

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None.

Item 6. Exhibits

The following exhibits are filed with this document:

| Exhibit No. | Description   |
|-------------|---|
| 10.1 (1)    | - Amended and Restated Unsecured Promissory Note dated as of April 30, 2014, issued by American Power Group Corporation (formerly GreenMan Technologies, Inc.) in favor of the Allen Kahn Revocable Trust AKA Allen Kahn, M.D. Revocable Trust. |
| 10.2 (1)    | - Amendment No. 2 dated April 30, 2014, to Promissory Note dated as of October 12, 2011, issued by American Power Group, Inc. in favor of Lyle Jensen.  |
| 10.3 (1)    | - Amendment N0. 2 dated April 30, 2014, to Unsecured Promissory Note dated as of September 17, 2010, issued by American Power Group Corporation (formerly, GreenMan Technologies, Inc.) in favor of Charles E. Coppa.                           |
| 31.1 (2)    | - Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a)   |
| 31.2 (2)    | - Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a)   |
| 32.1 (3)    | - Certification of Chief Executive Officer under 18 U.S.C. Section 1350   |
| 32.2 (3)    | - Certification of Chief Financial Officer under 18 U.S.C. Section 1350   |
| 101.SCH (4) | - XBRL Taxonomy Extension Schema Document   |
| 101.CAL (4) | - XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF (4) | - XBRL Taxonomy Extension Definition Linkbase Document  |
| 101.LAB (4) | - XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE (4) | - XBRL Taxonomy Extension Presentation Linkbase Document  |

(1) Filed as an exhibit to American Power Group Corporation's Current Report, as amended, on Form 8-K/A filed on May 28, 2014.

(2) Filed herewith.

(3) In accordance with Item 601(b)(32)(ii) of Regulation S-K, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed to be "filed" for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filings under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

(4) In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be "filed" or part of a registration statement for purposes of Sections 11 and 12 of the Securities Act, shall not be deemed "filed" for purposes of Section 18 of the Exchange Act and is not otherwise subject to liability under these sections, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act except as expressly set forth by specific reference in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

American Power Group Corporation

By: /s/ Lyle Jensen

Lyle Jensen

President & Chief Executive Officer

(Principal Executive Officer)

By: /s/ Charles E. Coppa

Charles E. Coppa

Chief Financial Officer

(Principal Accounting and Financial Officer)

Dated: June 29, 2015